Supreme Court, U.S.
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No.

In the Supreme Court of the United States

TIMOTHY BURKE,

Petitioner

v.

COMMISSIONER OF THE INTERNAL REVENUE SERVICE

Respondent

On Petition for a Writ of Certiorari
To the First Circuit Court of Appeals

PETITION FOR A WRIT OF CERTIORARI

Timothy J. Burke
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October 15, 2007

QUESTION PRESENTED

Whether income must be reported by a partne when partnership proceeds have been frozen during the tax year of the freezing.

LIST OF ALL PARTIES

The parties are those listed in the Caption.:

Timothy J, Burke, Petitioner.

Commissioner of Internal Revenue, Respondent.

CORPORATE DISCLOSURE STATEMENT

The Petitioner is not a corporation. The Respondent is the United States.

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Petitioner Timothy Burke respectfully petitions the Court for a writ of certiorari to review the decision below of the United States Court of Appeals for the First Circuit.

OPINION BELOW

The opinion of the First Circuit Court of Appeals is reported at 485 F.3d 171 (1st Cir. 2007). The opinion of the United States Tax Court is reported as T.C. Memo. 2005-297 (2005).

JURISDICTION

The court of appeals affirmed the United States Tax Court's opinion on May 4, 2007. A timely petition for a panel hearing and for a rehearing en banc was denied on July 16, 2007. (App. at 1.)

The jurisdiction of this court is invoked under 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

26 U.S.C. § 702 (in pertinent part) states:

> (a) GENERAL RULE
> In determining his income tax, each partner shall take into account separately his distributive share of the partnership's--...

(8) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

26 U.S.C. § 703 (in pertinent part) states:

(a) INCOME AND DEDUCTIONS
The taxable income of a partnership shall be computed in the same manner as in the case of an individual...

The provisions of 26 U.S.C. § 703 and 26 U.S.C. § 703 are lengthy. They are reproduced in the appendix at pages 30 through 33.

STATEMENT OF THE CASE

The facts as found by the Tax Court, with two exceptions, are largely not in dispute. They are restated, with notation of the exceptions, as follows:

On October 13, 1993, the Petitioner formed a partnership (the partnership) with Jeffrey Cohen, named "Cohen & Burke", to practice law and prepare tax returns. The partnership agreement provided that, from October 13 through December 31, 1993, each partner would be entitled to 100 percent of the income attributable to business that partner

generated. The partners agreed that beginning January 1, 1994, each partner who originated new business would receive an origination fee of 10 percent of the billing from that business. The remainder of the profits and losses was to be split equally.

Disagreement arose between petitioner and Mr. Cohen shortly after formation of the partnership. During December 1995, the partnership agreement was terminated.

As a result of representations made by Mr. Cohen, during January 1996, the parties agreed to conduct the partnership under a new oral agreement (the new agreement). Pursuant to the new agreement, the partnership's income was allocated as follows: (1) a guaranteed payment of 10 percent of the gross profits from the tax return preparation business would be paid to the originating partner; (2) 100 percent of the gross profits from legal services attributable to each originating partner was allocated

to that partner; (3) the remaining net profits were allocated equally to each partner; and (4) with respect to work referred from one partner to the other, a referral fee of 33 percent of gross profits from the referred work would be paid to the referring partner. The new agreement was effective from January 1, 1996 through December 31, 1998.

The Petitioner prepared and filed the partnership returns (including schedules) for the 1996 and 1997 taxable years and allocated the partnership's income in accordance with the new agreement.

During early 1998, Mr. Cohen began stating that he had never agreed to the new agreement. Mr. Cohen's statements caused a dispute which resulted in a deadlock: petitioner and Mr. Cohen agreed to pay expenses but could not agree on distributions. On September 18, 1998, Mr. Cohen's attorney sent petitioner a letter warning (the Tax Court found that it was a suggestion) that petitioner and Mr. Cohen

should not remove or dissipate any of the partnership's assets, except as required in the normal course of business.

During 1998, it became clear that Mr. Cohen and petitioner could not resolve their disputes without litigation. No later than November 1998 money received by the partnership was stolen by Mr. Cohen, who opened a legal practice that was in direct competition with Cohen & Burke. Mr. Cohen and petitioner began to place the partnership receipts in an escrow account until the dispute could be resolved.

Mr. Cohen prepared Form 1065, U.S. Partnership Return of Income, (including schedules), for the 1998 taxable year reporting $242,000 in ordinary income, and, on October 14, 1999, filed the Form 1065 with the Andover, Massachusetts, Internal Revenue Service Center. The Schedules K-1, Partner's Share of Income, Credit, Deductions, etc., issued to Petitioner and Mr. Cohen reported each partner's distributive share as $121,000. On October 20, 1999,

petitioner filed his Form 1040, U.S. Individual Income Tax Return, for the 1998 taxable year reporting zero as his distributive share of partnership income and filed, along with his Form 1040, a notice of inconsistent determination stating that the Form 1065 was replete with factual and legal inaccuracies.

On October 4, 1999, petitioner filed suit against Mr. Cohen in the Massachusetts Superior Court requesting damages for breach of fiduciary duty, breach of contract, deceit, and conversion and requesting an accounting.

At the time the lawsuit was filed, the Petitioner did not, know the sum of the stolen deposits. During the course of the state court litigation, the Petitioner learned that Mr. Cohen had not been forthcoming regarding all of the partnership's income. Petitioner prepared an analysis of the partnership income for the 1998 taxable year and determined, on the basis of the new agreement and the information available to him, that he was entitled to approximately $151,000.

Mr. Cohen's position, in the lawsuit was that the partners were entitled to only 50 percent of the partnership's profits each and were not entitled to any amounts based on the new agreement. On October 16, 2002, the jury found for the Petitioner "with regard to the partnership between January 1, 1996 through December, 31, 1998"; i.e., the income of the partnership should be allocated according to the new agreement. Although the Petitioner received a favorable jury verdict, as of the time of the submission of the parties' moving papers in the instant case, the partnership receipts remained (and remain) in escrow.

The Tax Court also found that "After petitioner provided respondent an income analysis of the partnership's income for 1998 during discovery, respondent increased the deficiency to $53,077. Using the income analysis petitioner provided the Respondent determined the Petitioner's distributive share under the new agreement was $151,682." In his

statement of facts in dispute the Petitioner maintained that the Respondent has inaccurately calculated the amounts which it maintained was income.

The Petitioner filed his Petition with the United States Tax Court on August 19, 2004.

On November 6, 2004 the Respondent filed a Motion for Summary Judgment. On February 10, 2005, the Petitioner filed an Opposition to the Respondent's Motion and filed a Cross Motion for Summary Judgment. The Respondent filed an Opposition to the Petitioner's Motion on February 24, 2005.

The Tax Court issued its Opinion on December 27, 2005 and entered its Order and Decision on January 18, 2006.

The Petitioner filed a Motion to Vacate or Revise the Court's decision and a Motion to Reconsider the Tax Court's Opinion on January 27, 2006. The Respondent opposed the Petitioner's motion on

February 15, 2006. The Tax Court issued an order granting, in part, the Motion for Reconsideration on March 1, 2006.

Appeal was filed on May 23, 2006.

The First Circuit Court of Appeals issued its opinion on May 4, 2007.

A timely motion for Rehearing and for an En Banc Hearing was made and denied on July 16, 2007.

REASONS FOR ALLOWANCE OF THE WRIT

This matter, while specific to Internal Revenue Code Section 703, has wide application as the holdings of the lower Courts are inapposite to longstanding precedent, including precedent of this Court, which hold that income is not reportable when proceeds are held in escrow as a result of a dispute.

The precedent's relied upon by the Petitioner, as acquiesced to by the Respondent over sixty years ago, all support the proposition that funds which are placed into escrow until a dispute over those funds is resolved are not income until the restriction is

removed.

1. Proceeds which are Held in Escrow as a Result of a Dispute are Not Income During the Term of the Escrow

In North American Oil Consolidated v. Burnett, 286 U.S. 417, 424 (1932), this Court stated:

> If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income...

This Court clearly holding that a prerequisite for the recognition of income is the absence of restrictions on the distribution of what has been received.

The Court's holding has stood undisturbed for nearly seventy years.

In Preston v. Commissioner, 35 B.T.A.(1937) acq., 1937-2 C.B. 22., John W. Preston ("Mr. Preston") and James F. Peck ("Mr. Peck") were employed by "Herminghaus heirs" to represent them. The agreement was initially oral but later reduced to writing. At the time that the attorneys were retained, Mr. Preston was a member of a partnership with

Robert Duncan ("Mr. Duncan"). All the parties understood that Mr. Duncan might assist in furnishing legal services to the Herminghaus heirs.

Mr. Preston and Mr. Duncan agreed that Mr. Duncan would receive one-half of the amounts received by Mr. Preston from the Herminghaus heirs after deduction of expenses.

Mr. Preston and Mr. Duncan's partnership dissolved on or about December 24, 1926. Mr. Duncan continued to perform services for the Herminghaus heirs

In the early part of December, 1926 payments were made to the Herminghaus heirs of $260,000. and fees paid to Mr. Preston and Mr. Peck the sum of $35,000. Mr. Preston and Mr. Peck divided the fees equally. Mr. Duncan was paid as agreed.

On or about November 1, 1927, the Herminghaus heirs, without informing Mr. Preston or Mr. Peck, sold the lands which were the subject of the legal services. A dispute arose between the attorneys

and the Herminghaus heirs as the entitlement of the attorneys to fees. Litigation commenced, the attorneys prevailed, and on December 9, 1930, the Herminghaus heirs delivered to Mr. Preston a check made payable jointly to John W. Preston and James F. Peck in the amount of $311,447.65. (The judgment was for a higher amount, $314,597.65, but subject to offsets.)

A dispute arose between Mr. Preston and Mr. Peck as to the amounts each was entitled to. The check was deposited to a joint account. After negotiations, they agreed that each would take $100,000. and leave the remainder in the joint account "pending adjustments of the controversy". On December 11, 1930, when he received $100,000 cash from the joint account, Mr. Preston immediately turned over to Adele Duncan, assignee of Robert Duncan, the sum of $50,000. Mr. Preston maintained that his gross income from the Herminghaus heirs fee was $100,000. against which he was to be allowed the

$50,000. paid to Mr. Duncan as a deduction(and other minor adjustments). The Respondent alleged that the Petitioner was to report one half of the gross fee or $157,298.82 less the amount paid to Mr. Duncan (and other minor adjustments).

At page 322, the Board of Tax Appeals stated and held as follows:

> The respondent contends that if Preston is not taxable upon a greater amount such a result: would place within the hands of the taxpayer the power to elect the year in which income subject to dispute shall be taxable to him. Instead of agreeing with Peck to receive $100,000 each in 1930 from the proceeds of the check, the petitioner could have agreed to receive any lesser sum, and by determining from time to time with Peck the amount to he distributed to each could elect not only the year in which the income is to be taxed to him but also the amount. Such a result does violence to the position consistently adhered to that it is not open to taxpayers to postpone the incidence of taxation. *Heinz v. Commissioner* C. C. A. 5th, 1934) 70 F.(2d) 461; *Newman v. Commissioner* C. C. A. 10th, 1930) 41 F. (2d) 743. * *
>
> The facts in the instant proceedings do not show an attempt on the part of either Preston or Peck to postpone the incidence of taxation. The case before us must be decided upon realities and not upon hypotheses. Preston is taxable in 1930 only upon the amount of

> income received to his "separate use." *Eisner v. Macomber*, supra. He did not in 1931 receive to his separate use an amount in excess of $51,746.19, the amount upon which he admits he is taxable.

In the present matter there are striking similarities to the holding in Preston. In each the principals were attorneys, expenses were paid (such expenses not being disputed by the Respondent), a dispute arose over the entitlement of the attorneys to their share of fees and the disputed amounts were held in a joint account where distributions to the principals were not to be made until the dispute was resolved.

The only difference being that in the present matter the Petitioner was a member of a partnership. This fact is without legal consequence as the calculation of taxable income is the same for a partnership and an individual. United States v. Basye, 410 U.S. 441, 448 (1973); IRC Section 703(a).

Additionally, while not addressed in the Preston matter, the agreement between Mr. Peck and Mr.

Preston meets all of the tests to be considered a joint venture. Please see Beck Chemical Equipment Corporation v. Commissioner, 27 TC 840 (1957).

Similarly, in Madigan v. Commissioner, 43 B.T.A. 549 (1941) acq. 1941-1 C.B. 7, the Petitioner ("Mr. Madigan" or the "Petitioner") was a coach and athletic director of St. Mary's College. Mr. Madigan's compensation was $7,000 a year plus 10 percent of St. Mary's share of the football receipts reduced by prescribed adjustments. His share of the receipts of 1934 and 1935 amounted to $21,690.62 but payment had not been made to him.

St. Mary's played a game with Fordham University on October 24, 1936, at New York. In November, 1936 a check for $38,324.15 was received from Fordham by the Petitioner. The check was payable to the St. Mary's College Athletic Association. The president of St. Mary's endorsed the check to Mr. Madigan, with the stated understanding that petitioner was to take the $21,690.62 due him for

1934 and 1935 and to hold the balance in trust until the accounting could be completed for the 1936 season. The Petitioner on November 25, 1936, deposited the check in a joint savings bank account of him and his wife. The funds were left untouched until after the accounting for the 1936 season which occurred in March of 1937.

The accounting in March 1937 showed that Mr. Madigan was to return $1,339.71 to St. Mary's.

The Petitioner's return for 1936 included the income due to him for the 1934 and 1935 seasons but not the 1936 season.The Respondent alleged that the Petitioner was required to report the entire amount received as income for 1936. The Court found:

> The evidence is clear, however, that the amount in excess of the 1934 and 1935 commissions, while actually taken into petitioner's possession, was received by him not for his own use or subject to his dominion and control but subject to the express instructions of the president of the college when he endorsed and delivered the check, that petitioner "was to hold the balance in trust until the accounting could be completed for the 1936 season." These were not empty words, for there were circumstances which gave them sound reason. No one could

> tell until after the 1936 accounting whether petitioner would be entitled to any commission for the season, and certainly not what the amount, if any would be. Prior to the accounting determination of the amount, petitioner had and claimed no right to use or enjoy any of the check except the amount of his 1934 and 1935 commissions which had been fixed and determined. This much he returned for tax in his 1936 income. The Commissioner was in error in adding any additional amount of the Fordham check. *Sara B. Preston*, 35 B. T. A. 312; cf. *North American. Oil Consolidated v. Burnet*, 926 U. S. 417; *Doyle v. Commissioner*, 110 Fed.(2d) 157: certiorari denied, 311 US 658.

In Madigan, the Court again found that when a taxpayer holds funds for which there was uncertainty as to the person who was to receive same that income does not arise until certainty is achieved.

In Fairbanks v. Commissioner 3 T.C. 260 (1944) the Petitioner (the "Petitioner" or the "estate") held two pieces of property which were leased to the Sun Oil Company These rentals were specifically bequeathed to the decedent's four children and her husband. The children and the decedent's husband were each to receive an equal one fifth share which was to be distributed annually. In 1940, a dispute

arose between the executors and the decedent's husband over the division of the decedent's property. The payor of the rentals, the Sun Oil Co., deposited the rental in a bank account in Houston, Texas. The funds could not be withdrawn from the joint account without the signature of the decedent's husband and the executors. The decedent's husband refused to sign any checks in 1940 except to pay the real estate taxes on the leased land.

In filing the income tax return for the estate the executors claimed a deduction for income distributed to beneficiaries as a deduction. The executors' position being that the requirement of a current distribution supported the deduction. The Court disallowed the deduction and held:

> Further, the balance in the joint bank account after the payment of ad valorem taxes, all of which was in dispute, was not received by the estate in 1941 and can not be included in its gross income for that year. *Sara Preston*, 35 B.T.A. 312 followed.
> The situation which we have in the instant case is in some important respects similar, we think, to the facts of *Sara R. Preston*, 35 B.T.A. 312. In that case we held that where two

> attorneys performed Services for clients and received a check in payment therefore payable to the order of both, who could not agree as to the amount to which each was entitled, and the check was deposited in a bank to the joint account of both and there was drawn from the joint account during the taxable year such amount as each conceded the other entitled to, the balance to be withdrawn upon settlement of the difference between them each attorney on a cash receipts and disbursements basis was required to include in gross income only the cash withdrawn his separate use. It is true, of course, that in the *Preston* case the taxpayers were individuals, while here, the taxpayer is an estate in the process of administration, but we think that makes no difference. The rules with respect to the receipt of income are the same in both instances.[Emphasis added.]

The taxable income of an estate or trust is computed in the same manner as an individual or a partnership. Please see IRC § 641(b) and IRC Section 703(a).

The Tax Court's holding in Fairbanks is in complete accord with its holdings in Madigan and Preston.

Each of these precedents hold that when there is a dispute between parties which raises uncertainty as to the entitlement to funds and that the funds are

held in a bank account from where distributions are not made until the resolution of the dispute, that income does not arise until such time that the restriction on the funds is released. The Respondent acquiesced to this principal governing the taxation of matters such as here over sixty years ago. Its arguments in the present matter are inconsistent with the position that it has publicly accepted.

Here as in Preston v. Commissioner, 35 B.T.A.(1937) acq., 1937-2,C.B. 22., Madigan v. Commissioner, 43 B.T.A. 549 (1941) acq. 1941-1 C.B. 7, and in Fairbanks v. Commissioner 3 T.C. 260 (1944), the restriction on the funds which defers the recognition of income at the partnership level, as it does for individuals, until the restriction is removed.

The First Circuit Court of Appeals in its holding recognized that Internal Revenue Code § 703 requires that partnership income be calculated on the same basis as individuals.

The Petitioner maintains that the First Circuit

Court of Appeals erred when it found a "self imposed restriction" on the subject proceeds.

The restriction on the funds was not a voluntary agreement between taxpayers whose motivation was to defer taxation on funds to a subsequent tax year. The genesis of the escrow was a deadlock between the partners followed by Mr. Cohen's counsel's September 18, 1998 letter stating that the Petitioner and Mr. Cohen should not remove or dissipate any of the partnership's assets.

The restriction on the funds was not "voluntary" it was the result of a dispute between the partners.

The First Circuit's reliance on Reed v. Commissioner, 723 F.2d 138 (1st Cir. 1983) was misplaced.

The Appellant in Reed negotiated a change to a Purchase and Sale Agreement so as to effect the deferral of income. Here, the escrow was established no later than September 18, 1998 when Mr. Cohen's counsel informed the Petitioner that neither he nor

Mr. Cohen should remove or dissipate any partnership assets.

The circumstances herein are entirely distinct from a those of a taxpayer who chose to structure a transaction in a blatant attempt to misconstrue the economic reality of the transaction.

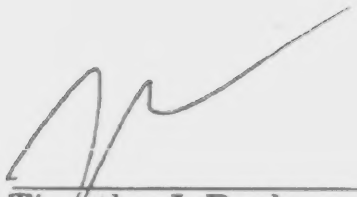
The First Circuit's finding that the escrow was a self imposed restriction is legal error.

The Court's error crucially flawed its analysis.

The principal relied on by the Petitioner is a fundamental tenet of tax law. Certiorari is properly granted so as to avoid confusion (and error) in a long settled are of the tax law.

CONCLUSION.

For the foregoing reasons, the Petitioner respectfully requests that the Supreme Court grant review of this matter



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Dated: December 5, 2007

APPENDIX

United States Court of Appeals
For the First Circuit

No. 06-1865

TIMOTHY J. BURKE,
Petitioner, Appellant,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent, Appellee.

Before
Boudin, Chief Judge,
Gibson,* Senior Circuit Judge,
Torruella, Lynch,
Lipez and Howard,
Crcuit Judges.

ORDER OF COURT
Entered: July 16, 2007

The petition for rehearing having been denied by the panel of judges who decided the case, and the petition for rehearing en banc having been submitted to the active judges of this court and a majority of the judges not having voted that the case be heard en banc, it is ordered that the petition for rehearing and the petition for rehearing en banc be denied.

By the Court:
RICHARD CUSHING
DONOVAN Richard Cushing
Donovan, Clerk

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*Of the Eighth Circuit, sitting by designation.

United States Court of Appeals
For the First Circuit

No. 06-1865

TIMOTHY J. BURKE,
Petitioner, Appellant,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent, Appellee.

APPEAL OF AN ORDER OF THE UNITED STATES TAX COURT

Before
Torruella, Circuit Judge,
John R. Gibson[1]
and Lipez, Circuit Judge.

Timothy J. Burke, for appellant.

Jonathan S. Cohen, Attorney, Tax Division, U.S. Department of Justice, with whom Eileen J. O'Connor, Assistant Attorney General, and Regina S. Moriarty, Attorney, Tax Division, were on brief, for appellee.

May 4, 2007

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[1] Of the Eighth Circuit sitting by designation.

TORRUELLA, Circuit Judge. On May 14, 2004, Timothy J. Burke received a notice of deficiency from the Internal Revenue Service ("IRS") stating that Burke owed taxes on his distributive share of his partnership's income for 1998. Burke petitioned the tax court for a redetermination of his tax liability, arguing that he was not liable for tax on his 1998 distributive share because the partnership's receipts were placed in escrow. The tax court rejected Burke's argument and granted the IRS's motion for summary judgment. Burke appeals the tax court's ruling. After careful consideration, we affirm.

I. Background

On October 13, 1993, Burke formed a partnership with Jeffrey Cohen named "Cohen & Burke," agreeing to split the proceeds of the enterprise evenly after allocating a ten percent origination fee to the partner who generated new business. In 1998, a dispute arose between the two partners when Cohen allegedly refused to comply with a superseding partnership agreement that linked the distribution of the partnership's proceeds more tightly to each partner's individual efforts[2] and stole money

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[2] Burke alleges that on January 1, 1996, Burke and Cohen entered into an oral partnership agreement (the "partnership agreement"),pursuant to which the partnership's income was to be allocated as follows: (1) A guaranteed payment of 10 percent of the gross profits from the tax return preparation business would be paid to the originating partner; (2) 100 percent of the gross profits from legal services attributable to each originating partner was allocated to that partner; (3) the remaining net profits were allocated equally to each partner; and (4) with respect to work referred from one partner to the other, a referral fee of 33 percent of gross profits from the referred work would be paid to the referring partner. Burke prepared and filed the partnership returns

received by the partnership. As a result of the dispute, Burke filed suit against Cohen in Massachusetts state court on October 4, 1999, alleging breach of fiduciary duty, breach of contract, deceit, and conversion, and requesting an accounting. Cohen and Burke agreed to keep the partnership receipts in an escrow account pending the outcome of the litigation.

Meanwhile, Cohen filed the partnership tax return for 1998 reporting $242,000 in ordinary income, with $121,000 as each partner's distributive share.[3]

Close Burke reported zero as his distributive share of partnership income and filed a notice of inconsistent determination stating that Cohen's partnership tax filing was factually and legally inaccurate.

The Commissioner of Internal Revenue issued Burke a notice of deficiency alleging that Burke had improperly failed to report his distributive share of partnership income on his individual return. Burke timely petitioned the tax court for redetermination of the deficiency, claiming that his distribution of partnership income from 1998 should not have been taxed that year because the money was being held in escrow and he therefore did not have access to it. The IRS filed a motion for summary judgment arguing that, as a matter of law, a

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for 1996 and 1997 in accordance with the partnership agreement.

[3] Cohen's position in the state court litigation was that the partnership agreement was not valid and that each partner was entitled to fifty percent of the partnership's profits. On October 16, 2002, the jury found for Burke "with regard to the partnership between January 1, 1996 through December 31, 1998"; i.e., that the income of the partnership should be allocated according to the partnership agreement.

partner's distribution of partnership income was taxable in the year the partnership received the income, regardless of whether the partner actually received the distribution. Burke filed an opposition to the IRS's motion for summary judgment claiming that there were material facts in dispute precluding summary judgment in favor of the IRS and moved for partial summary judgment on the issue of whether he was required to report his distributive share of the 1998 partnership income. The tax court granted summary judgment in favor of the IRS, holding that Burke was required to include his distributive share of partnership income for the 1998 taxable year even though he had not yet received that distribution.

II. Discussion

We review the award of summary judgment de novo. *State Police Ass'n v. Comm'r*, 125 F.3d 1, 5 (1st Cir. 1997).

A. Burke's 1998 Taxable Income

Section 701 of the Internal Revenue code provides that "[a] partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities." 26 U.S.C. § 701. Section 703(a) provides that "[t]he taxable income of a partnership shall be computed in the same manner as in the case of an individual." Id. § 703(a).

Burke argues that his distribution of partnership income for 1998 should not have been taxed that year because that income was (and remains) "frozen" in an escrow account, such that neither he, nor his partner, has access to the income. In support of his argument, Burke cites several cases (none of which deal with partnership or partner taxation) that hold that an individual taxpayer

must only include income to which he has a claim of right. See, e.g., *N. Am. Oil Consol. v. Burnet*, 286 U.S. 417, 422 (1932) (holding that profits earned by taxpayer in a given year are not taxable income until taxpayer "first became entitled to them and when [taxpayer] actually received them").

Citing 703's language that "[t]he taxable income of a partnership shall be computed in the same manner as in the case of an individual," Burke contends that under these cases, the partnership did not earn taxable income in 1998 because "the restriction of funds . . . defers the recognition of income at the partnership level, as it does for individuals, until the restriction is removed."

But 703 does not help Burke. A self-imposed restriction on the availability of income cannot legally defer recognition of that income. See *Reed v. Comm'r*, 723 F.2d 138, 143 (1st Cir. 1983) ("[A] 'self-imposed limitation' created by the [taxpayer] is legally ineffective to shift taxability on escrowed funds from one year to the next."). The partnership received the money free and clear in 1998. It was the individual partners, Burke and Cohen, who chose to place the funds in escrow - not the partnership's clients or other persons owing the partnership money. Compare with id. at 142 ("As long as the deferred payment agreement is binding between the parties and is made prior to the time when the [taxpayer] has acquired an absolute and unconditional right to receive payment, then the . . . taxpayer is not required to report the . . . income until he actually receives [it]."). Thus, Burke's contentions have only to do with the individual partners' access to the funds after they were placed in escrow and not the partnership's access to them. It is well settled that partners' distributions are taxed in the year the partnership receives its earnings, regardless of whether the partners actually receive their share of

partnership earnings: "Few principles of partnership taxation are more firmly established than that no matter the reason for nondistribution each partner must pay taxes on his distributive share." *United States v. Bayse*, 410 U.S. 441, 454 (1973); see also *Heiner v. Mellon*, 304 U.S. 271, 281 (1938) ("The tax is . . . imposed upon the partner's proportionate share of the net income of the partnership, and the fact that it may not be currently distributable, whether by agreement of the parties or by operation of law, is not material."); 26 C.F.R.§ 1.702-1 (providing that a partner must separately account for his distributive share of partnership income "whether or not distributed"). Consistent with this long-standing principle, courts have uniformly held that partners must currently recognize in their individual incomes their proportionate shares of partnership income, even if the partnership income was not actually distributed to them for any reason, including disputes, consensual arrangements, ignorance, concealment, or force of law. See, e.g., *Heiner*, 304 U.S. at 280-81 (holding partners liable for tax on their distributive share of liquidating partnership's net profits in the year earned, even though proceeds from the sale of partnership assets were not distributed until a year later); *Comm'r v. Goldberger's Estate*, 213 F.2d 78, 81-82 (3d Cir. 1954) (holding taxpayer liable for distributive share of profits earned by joint venture, even though he was ignorant of the full extent of the profits and did not receive his distributive share until years later)[4]

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[4] Under 26 U.S.C. 7701(a)(2), the term "partnership" includes a"joint venture . . ., through or by means of which any business, financial operation, or venture is carried on, and which is not,within the meaning of this title, a trust or estate or a corporation; and the term 'partner' includes a member in such a

Earle v. Comm'r, 38 F.2d 965, 967-68 (1st Cir. 1930) (requiring members of partnership which was dissolved during taxable period by death of one of the partners to report their respective proportions of partnership income on their individual income tax return, whether distributed or not). Thus, Burke was required to report his distributive share of the partnership's income in 1998, even if he had not yet received it.

B. Facts in Dispute

Burke also argues that the tax court erred in granting summary judgment in favor of the IRS because there were facts in dispute which may affect the outcome of the lawsuit. He claims that the court incorrectly assumed Burke's taxable income for 1998 was "approximately $151,000," when, in fact, that number was disputed on the ground that it included money that Cohen had stolen from the partnership.

The IRS states (and the tax court found) that the IRS used Burke's own calculation of the partnership's gross receipts for 1998, subtracting from that number Burke's calculations of the allegedly stolen funds, in arriving at Burke's taxable income for 1998. This assertion is supported by the record and Burke does not directly contest it. Instead, he asserts -- without citing to the IRS's calculations -- that Cohen's tax filings were inaccurate because he had included the allegedly stolen partnership income in the calculation of the partnership's gross receipts. Perhaps there would have been a genuine issue of material fact if, in fact, the IRS had used Cohen's tax filings to arrive at the $151,000 figure for 1998

. . . joint venture."

taxable income to Burke, but the IRS did not. The IRS used Burke's calculations of partnership income. Accordingly, the facts to which Burke refers are not actually in dispute.

III. Conclusion

For the reasons stated above, we affirm the tax court's order and opinion.

Affirmed.

UNITED STATES TAX COURT

TIMOTHY J. BURKE, Petitioner	)	
v.	)	Docket No. 14904-04.
COMMISSIONER OF INTERNAL REVENUE, Respondent	)	

ORDER

This matter is before the Court on petitioner's motions for reconsideration and to vacate or revise decision in this case issued with respect to our prior opinion, Burke v. Commissioner, T.C.Memo. 2005-297 (prior opinion).

We grant, to the extent set forth below, petitioner's motion to reconsider, which results in no change to our decision in thiscase, and we deny petitioner's motion to vacate or revise. decision.

The petition in this case was filed on August 19, 2004. On January 12, 2005, respondent filed a motion for summary judgment.On February 10, 2005, petitioner filed a response opposing respondent's motion for summary judgment and moving for partial summary judgment on the issue of whether petitioner is required to include his distributive share of partnership income for the 1998 taxable year. In our prior opinion, the Court held for respondent.

We address the issues in the same order as in our prior opinion.

1. Whether Petitioner Must Include in His Distributive Share of Partnership Income for the 1998 Taxable Year Amounts That Are in Dispute Between the Former Partners.

Petitioner contends that the Court erred in its prior opinion by ignoring the plain meaning of section 703(a) and by holding that the precedents governing the recognition of income by individuals do not apply to partnerships, thereby further disregarding the statutory requirement of section 7.03(a)

We disagree. We did not hold that the precedents governing the recognition of income, such as the claim of right doctrine, cannot apply to partnerships. The claim of right doctrine does not apply to Cohen & Burke, the partnership in issue in this case, because there was not a restriction on receipt of the income at the partnership level; i.e. at Cohen & Burke's level.

Moreover,. section 703(a) provides, in pertinent part: "(a) Income and deductions.--The taxable income of a partnership shallbe computed in the same manner as in the case of an individual except that.-- [items described in section 702(a) are separately stated and certain deductions are not allowed to the partnership.]."

Accordingly, the partnership is treated as a hypothetical entity,. apart from its partners, for the purpose of calculating taxable income from gross income except as provided in 703(a)(1) and (2). In United States v. Basye,410 U.S. 441, 448 (1973) the Supreme Court

stated:

> For this. purpose then, the partnership is regarded as an independently recognizable entity apart from the aggregate of its partners. Once its income is ascertained and reported, its existence may be disregarded since. each partner must pay tax on a portion of the total income as if the partnership were merely an agent or conduit through which the income passed.

Thus, once the taxable income is calculated, the hypothetical entity (the partnership) is disregarded, and the income is passed through to the individual partners. The claim of right doctrine prevents inclusion at the individual partner level only if there is a restriction on receipt at the level of the hypothetical entity. Such a restriction is not present in this case.

Petitioner misinterprets the above quoted statement in Bayse. That statement highlights the conduit, or pass through, nature of partnerships. Bayse,and section 703(a) do not provide, contrary to petitioner's interpretation, that, if there is a restriction on the disposition of the income to the partners after the income has been earned by the partnership, then it is omitted from the partner's distributive share.

Petitioner offered no evidence showing that there was a restriction on Cohen .& Burke's receipt-of the disputed funds.

The money was paid by the clients. Cohen .& Burke had not ceased to exist. Mr. Cohen simply stole the funds from Cohen & Burke and refused to comply with the

partnership agreement. After a dispute arose, the funds were placed in escrow. This is different than a restriction at the partnership level, for example, where a. client refuses to pay.

The fact that Mr. Cohen started a practice that was in competition. with Cohen & Burke is immaterial. In his initial briefs, petitioner repeatedly stated, "Mr. Cohen took receipts and started a practice in competition with Cohen & Burke." Petitioner presented no evidence showing that Mr. Cohen's new business had competing claims to the receipts already. earned by Cohen & Burke. Moreover, in his motion for reconsideration, petitioner points out that Mr. Cohen testified before the Massachusetts Superior Court that Mr. Cohen included the stolen funds in Cohen & Burke's partnership return for 1998. The inclusion of such funds in Cohen & Burke's partnership return for 1998 eviscerates petitioner's argument that there could have been a competing claim at the partnership level to which the claim of right doctrine might apply.

Furthermore, petitioner ignores several cases discussed in our prior opinion with facts very similar to those in this case. See Stoumen v. Commissioner,208 F.2d 903, 908 (3d Cir. 1953) (holding that the taxpayer's distributive share of partnership income was taxable to him in the year of realization by the partnership, despite the fact that his partner had embezzled funds that did not appear in the partnership books, and despite the fact that the taxpayer was unaware of the existence of the funds and never received any of them); see also First Mechs. Bank v. Commissioner, 91 F.2.d 275, 279(3d Cir. 1937) (holding the taxpayer liable for the higher amount of his distributive share for the tax year in issue despite the fact

that the taxpayer had settled for a lesser amount in a later year in order to end protracted litigation); Beck Chem. Equip. Corp. v. Commissioner, 27 T.C. 840, 855 (1957) (holding that the principles of scienter and actual receipt have no application to the issue of whether partners are to be charged with their distributive shares and rejecting the taxpayer's argument that a dispute with his partner made the calculation of his distributive share impossible and that the amounts were not established until a settlement was reached in a later year)

2. Whether Respondent Properly Calculated Petitioner's Distributive. Share:

Petitioner contends that the Court erred in it prior opinion.by holding that respondent was entitled to summary judgment on the issue of whether respondent properly calculated petitioner's distributive share. Petitioner repeatedly asserts that respondent improperly based his initial deficiency on the Form 1065, U.S. Partnership Return of Income, filed by Mr. Cohen for the 1998 taxable year.

Petitioner appears not to appreciate, however, the significance of respondent's contention that respondent calculated the increased deficiency based on an income analysis provided by petitioner. Petitioner acknowledges that contention in his motion to vacate or revise decision and states: "This position was advanced by respondent and objected to by petitioner."

In his response to respondent's motion for summary judgment, however, petitioner did not state that respondent incorrectly calculated petitioner's distributive share on the basis of the income analysis, nor did petitioner's affidavit create a genuine issue of fact in that

regard. In his response, petitioner stated: "The partnership received deposits. To have income the tests established by the Courts, the Internal Revenue Code and the regulations must be met. As is detailed in Petitioner's memorandum those tests were not met."

Petitioner fails to understand the summary judgment standard. Petitioner's burden on summary judgment is to set forth specific facts showing that a genuine question of material fact exists. Grant Creek Water Works, Ltd. v. Commissioner, 91 T.C. 322, 325 (1988); Casanova Co. v. Commissioner, 87 T.C. 214,217 (1986).. Petitioner does not dispute the facts pertinent to the calculation of his distributive share of the partnership's income for the year in issue. Petitioner's response is a legal argument that he does not have income under his theory of the case. Not only is this a legal conclusion, but it is also irrelevant because, pursuant to Stoumen v. Commissioner, supra, it does not matter if funds were stolen and the partner was not even aware of that fact; the partner must still include those funds in his distributive share.

3. Whether Petitioner May Deduct Certain Business Expenses..

Petitioner contends that the Court erred in granting respondent's motion for summary judgment with respect to whether petitioner was entitled to certain trade or business. deductions that he did not: include on his 1998 individual tax return. In his motion to vacate or revise decision, petitioner merely states: "For the record, the Petitioner maintains that there was sufficient evidence in the file to support this claim."

Petitioner's mere assertion that there was sufficient evidence in the record is incorrect and is insufficient justification to vacate or revise our prior decision on this issue. The record contained photo copies of checks that not only failed to correlate to the deductions claimed by petitioner but also lacked any explanation of their relationship to the expenses.

We have reconsidered the issues and find petitioner's contentions to be without merit. Accordingly, it is

ORDERED that petitioner's motion to reconsider is granted to the extent of the reconsideration herein contained. In all other respects, the prior opinion remains the same and results in no change to our decision in this case. Petitioner's motion to vacate or revise our decision is denied.

/s./ Thomas B. Wells
Thomas B. Wells
Judge

Dated: Washington, D. C.
March 1, 2006

T.C. Memo. 2005-297

UNITED STATES TAX COURT

TIMOTHY J. BURKE, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 14904-04. Filed December 27, 2005.

Timothy J. Burke, pro se.
Michael R. Fire, for respondent.

MEMORANDUM OPINION

WELLS, Judge: This matter is before the Court on respondent's motion for summary judgment pursuant to Rule 121 and petitioner's cross-motion for partial summary judgment. The issues[5] for decision are: (1) Whether petitioner is required to report his distributive share of partnership income for the 1998 taxable year despite the fact that his distributive share of that income was not actually distributed to him but is being held in escrow because of a dispute with his former partner; (2) whether respondent correctly calculated that distributive share; and (3) whether petitioner is entitled to deduct certain business expenses. After considering respondent's motion and petitioner's response, we conclude that there remain no issues of material fact that require trial. For the reasons stated below, we will grant respondent's motion for summary judgment and deny petitioner's

[5] Petitioner moves for partial summary judgment with respect to the first issue.

motion for partial summary judgment. Unless otherwise indicated, all Rule references are to the Tax Court Rules of Practice and Procedure, and all section references are to the Internal Revenue Code, as amended.

Background

At the time of filing the petition, petitioner resided in West Rosburghii, Massachusetts. Petitioner is an attorney, admitted to practice in Massachusetts and before the United States Tax Court, and a certified public accountant. On October 13, 1993, petitioner formed a partnership (the partnership) with Jeffrey Cohen, named "Cohen & Burke", to practice law and prepare tax returns. Shortly after formation, the partnership purchased a tax preparation practice owned by the estate of Mr. Cohen's father. The partnership agreement provided that, from October 13 through December 31, 1993, each partner would be entitled to 100 percent of the income attributable to business that partner generated. The partners agreed that, beginning January 1, 1994, each partner who originated new business would receive an origination fee of 10 percent of the billing from that business. The remainder of the profits and losses was to be split equally. Disagreement arose between petitioner and Mr. Cohen shortly after formation of the partnership. During December 1995, the partnership agreement was terminated. As a result of representations made by Mr. Cohen during January 1996, the parties agreed to conduct the partnership under a new oral agreement (the new agreement). Pursuant to the new agreement, the partnership's income was allocated as follows: (1) A guaranteed payment of 10 percent of the gross profits from the tax return preparation business would be paid to the originating partner; (2) 100 percent of the gross profits from legal services attributable to each originating

partner was allocated to that partner; (3) the remaining net profits were allocated equally to each partner; and (4) with respect to work referred from one partner to the other, a referral fee of 33 percent of gross profits from the referred work would be paid to the referring partner. The new agreement was effective from January 1, 1996, through December 31, 1998. Petitioner prepared and filed the partnership returns (including schedules) for the 1996 and 1997 taxable years and allocated the partnership's income in accordance with the new agreement. During early 1998, Mr. Cohen began stating that he had never agreed to the new agreement. Mr. Cohen's statements caused a dispute which resulted in a deadlock: petitioner and Mr. Cohen agreed to pay expenses but could not agree on distributions. On September 18, 1998, Mr. Cohen's attorney sent petitioner a letter suggesting that petitioner and Mr. Cohen should not remove or dissipate any of the partnership's assets, except as required in the normal course of business. During 1998, it became clear that Mr. Cohen and petitioner could not resolve their disputes without litigation. No later than November 1998, money received by the partnership was stolen by Mr. Cohen, who opened a legal practice that was in direct competition with Cohen & Burke. Mr. Cohen and petitioner began to place the partnership receipts in an escrow account until the dispute could be resolved. Mr. Cohen prepared Form 1065, U.S. Partnership Return of Income (including schedules), for the 1998 taxable year reporting $242,000 in ordinary income, and, on October 14, 1999, filed the Form 1065 with the Andover, Massachusetts, Internal Revenue Service Center. The Schedules K- 1, Partner's Share of Income, Credit, Deductions, etc., issued to petitioner and Mr. Cohen reported each partner's distributive share as $121,000. On October 20, 1999, petitioner filed his Form 1040, U.S. Individual Income

Tax Return, for the 1998 taxable year reporting zero as his distributive share of partnership income and filed, along with his Form 1040, a notice of inconsistent determination stating that the Form 1065 was replete with factual and legal inaccuracies. On October 4, 1999, petitioner filed suit against Mr. Cohen in the Massachusetts Superior Court requesting damages for breach of fiduciary duty, breach of contract, deceit, and conversion and requesting an accounting. Mr. Cohen and petitioner agreed to keep the partnership receipts in escrow. At the time the lawsuit was filed, petitioner did not know the sum of the stolen deposits. During the course of the State court litigation, petitioner learned that Mr. Cohen had not been forthcoming regarding all of the partnership's income. Petitioner prepared an analysis of the partnership income for the 1998 taxable year and determined, on the basis of the new agreement and the information available to him, that he was entitled to approximately $151,000.[6] Mr. Cohen's position in the lawsuit was that the partners were entitled to only 50 percent of the partnership's profits each and were not entitled to any amounts based on the new agreement. On October 16, 2002, the jury found for petitioner "with regard to the partnership between January 1, 1996 through December 31, 1998"; i.e., the income of the

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[6] Petitioner had previously analyzed the partnership's income, but that analysis lacked information regarding the deposits stolen by Mr. Cohen. The second analysis largely uses the same information regarding the partnership's income for 1998 but also includes certain deposits received by petitioner and not deposited in the partnership account and some of the deposits stolen by Mr. Cohen. Respondent deducted the stolen deposits from the calculation of the increased deficiency.

partnership should be allocated according to the new agreement. Although petitioner received a favorable jury verdict, as of the time of the submission of the parties' moving papers in the instant case, the partnership receipts remained in escrow pending the Massachusetts Superior Court's decision on petitioner's motion for an accounting. Respondent determined a $41,338 deficiency based on the $121,000 reported to petitioner on his Schedule K-1 and mailed petitioner a notice of deficiency on May 14, 2004. Petitioner timely petitioned this Court. After petitioner provided respondent an income analysis of the partnership's income for 1998 during discovery, respondent increased the deficiency to $53,077. Using the income analysis petitioner provided, respondent determined petitioner's distributive share under the new agreement was $151,682.

Discussion

Summary judgment is intended to expedite litigation and avoid unnecessary and expensive trials. *Fla. Peach Corp. v. Commissioner*, 90 T.C. 678, 681 (1988). Summary judgment may be granted where there is no genuine issue of material fact and a decision may be rendered as a matter of law. Rule 121(a) and (b). The moving party bears the burden of proving that there is no genuine issue of material fact, and factual inferences are viewed in a light most favorable to the nonmoving party. *Craig v. Commissioner*, 119 T.C. 252, 260 (2002); *Dahlstrom v. Commissioner*, 85 T.C. 812, 821 (1985); *Jacklin v. Commissioner*, 79 T.C. 340, 344 (1982). The party opposing summary judgment must set forth specific facts which show that a genuine question of material fact exists and may not rely merely on allegations or denials in the pleadings. *Grant Creek Water Works, Ltd. v.*

Commissioner, 91 T.C. 322, 325 (1988); *Casanova Co. v. Commissioner*, 87 T.C. 214, 217 (1986).

1. Whether Petitioner Must Include in His Distributive Share of Partnership Income for the 1998 Taxable Year Amounts That Are in Dispute Between the Former Partners

Section 701 provides: "A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities." In determining his income tax, each partner must separately include his distributive share of the partnership's taxable income or loss. Sec. 702(a)(8). As a general rule, a partner's distributive share of income, gain, loss, deduction, or credit is determined by the partnership agreement. Sec. 704(a). Section 1.702-1(a), Income Tax Regs., provides: "Each partner is required to take into account separately in his return his distributive share, whether or not distributed, of each class or item of partnership income". (Emphasis added.) "Few principles of partnership taxation are more firmly established than that no matter the reason for nondistribution each partner must pay taxes on his distributive share." *United States v. Basye*, 410 U.S. 441, 454 (1973). "The tax is thus imposed upon the partner's proportionate share of the net income of the partnership, and the fact that it may not be currently distributable, whether by agreement of the parties or operation of law, is not material." *Heiner v. Mellon*, 304 U.S. 271, 281 (1938); see also *First Mechs. Bank v. Commissioner*, 91 F.2d 275, 279 (3d Cir. 1937) (holding that a partner's share of partnership income was taxable to him for the year in which the income was realized by the partnership even though not distributed to the partner in that year); *Chama v. Commissioner*, T.C. Memo. 2001-253 (holding that a partner was taxable on

his share of partnership gain even though not distributed to him but instead reinvested by the partnership); *Johnston v. Commissioner*, T.C. Memo. 1984-374 (holding that each partner is taxed on his distributive share of partnership income without regard to whether the amount is actually distributed to him). Petitioner argues, however, that the existence of a real controversy between petitioner and Mr. Cohen rendered the amount of his distributive share indefinite and that the partnership receipts in escrow are "frozen" and therefore unavailable to petitioner. Petitioner cites section 703(a) for the proposition that the taxable income of a partnership is computed in the same manner as that of an individual and cites several cases to support his argument that his dispute with his former partner postpones the inclusion of his distributive share because he does not have a claim of right to the income. Petitioner chiefly relies on *North American Oil Consolidated v. Burnet*, 286 U.S. 417 (1932) (taxpayer must include income to which he has a claim of right); *Estate of Fairbanks v. Commissioner*, 3 T.C. 260 (1944) (dispute between executors and decedent's wife precluded inclusion in the estate's income); *Madigan v. Commissioner*, 43 B.T.A. 549 (1941) (taxpayer who placed funds in his personal account pending outcome of an accounting was not required to include the entire amount in income); *Preston v. Commissioner*, 35 B.T.A. 312 (1937) (dispute between two attorneys, who were not partners, precluded inclusion in income). Petitioner's reliance on the foregoing cases is misplaced for reasons discussed below. Petitioner acknowledges that none of the cases he cites involves a partnership. Instead he argues that, because partnership taxable income is computed in the same manner as that of an individual, the existence of a partnership does not matter. Petitioner argues that the combination of section 703(a) and the cited cases leads to

the conclusion that a taxpayer does not have income if there are restrictions on its receipt. We disagree with petitioner's argument for several reasons, the first of which is that the cases petitioner cites do not involve partnerships or partners' distributive shares. Cohen & Burke was a partnership, and, therefore, the cases petitioner cites do not apply. Secondly, section 703 describes how partnership income is computed; [7] i.e., how taxable income is calculated from gross income.[8] A partnership itself pays no taxes, sec. 701, but the income of the partnership must be reported, and that income is calculated generally in the same manner as an individual computes his personal income, *United States v. Basye*, supra at 448. In *Basye*, the Supreme Court stated: For this purpose then, the partnership is regarded as an independently recognizable entity apart from the aggregate of its partners. Once its income is ascertained and reported, its existence may be disregarded since each

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[7] SEC. 703(a). Income and Deductions.--The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that-- (1) the items described in section 702(a) shall be separately stated, and (2) the following deductions shall not be allowed to the partnership: (A) the deductions for personal exemptions provided in section 151, (B) the deduction for taxes provided in section 164(a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States, © the deduction for charitable contributions provided in section 170, (D) the net operating loss deduction provided in section 172, (E) the additional itemized deductions for individuals provided in part VII of subchapter B (section 211 and following), and (F) the deduction for depletion under section 611 with respect to oil and gas wells.

[8] See sec. 63(a) (defining taxable income as "gross income minus the deductions allowed by this chapter")

partner must pay tax on a portion of the total income as if the partnership were merely an agent or conduit through which the income passed. The issue here is not whether the partnership itself was entitled to income. Instead, the issue is whether petitioner was required to report for 1998 his distributive share of income that was already earned by the partnership during that year. The income was earned by the partnership during 1998, and there was nothing conditional or contingent about its receipt. Petitioner, therefore, was taxable on his distributive share of the partnership's profits for 1998, even though he did not receive it. See *First Mechs. Bank v. Commissioner*, 91 F.2d at 279. It is irrelevant that petitioner still may not know the full extent of the partnership income because of the deposits stolen by his partner, Mr. Cohen; the nonappearance of the deposits on the partnership books is not determinative. See *Stoumen v. Commissioner*, 208 F.2d 903, 908 (3d Cir. 1953) (holding that the taxpayer's distributive share of partnership income was taxable to him in the year of realization by the partnership, despite the fact that his partner had embezzled funds which did not appear in the partnership books, and despite the fact that the taxpayer was unaware of the existence of the funds and never received any of them), affg. A Memorandum Opinion of this Court[9]. Thirdly, a partner is taxable on his distributive share of partnership income when realized by the partnership despite a dispute among the partners as to their respective distributive shares. In *De Cousser v.*

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[9] We recognize that this is a harsh rule, but the harshness is mitigated somewhat by the theft loss deduction allowed under sec. 165(e), which, in pertinent part, provides: "any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss."

Commissioner, 16 T.C. 65 (1951), the taxpayer argued that a controversy with his partner rendered the amounts of his distributive share indefinite and impossible to determine and that those amounts were not specifically established until a settlement was reached during the last of the 3 years in issue. Id. at 71. We rejected the taxpayer's argument that taxation of his distributive share should be postponed on that account, and we noted that the purpose of his suit against his partner was to claim one-half of the profits and that the settlement seemed to have decided that question. Id. at 74. We held that the taxpayer's distributive share of the partnership profits had to be included in his income for the years in which those profits were earned by the partnership. Id.; see also *First Mechs. Bank v. Commissioner*, supra at 279 (holding the taxpayer liable for the higher amount of his distributive share for the tax year in issue despite the fact that the taxpayer had settled for a lesser amount in a later year in order to end protracted litigation); *Beck Chem. Equip. Corp. v. Commissioner*, 27 T.C. 840, 855 (1957) (holding that the principles of scienter and actual receipt have no application to the issue of whether partners are to be charged with their distributive shares and rejecting the taxpayer's argument that a dispute with his partner made the calculation of his distributive share impossible and that the amounts were not established until a settlement was reached in a later year); *Klein v. Commissioner*, 25 T.C. 1045 (1956) (rejecting the taxpayer's argument that a dispute between the taxpayer and his partner over his distributive share delayed inclusion until a later year when the funds were actually received). On the basis of the foregoing, we conclude that petitioner is taxable on his distributive share of partnership income for 1998 which includes the amounts in dispute between petitioner and his former partner even

though undistributed to petitioner. Accordingly, respondent is entitled to summary judgment on the issue of whether petitioner must include the disputed amounts in his distributive share of partnership income for the 1998 taxable year, and petitioner's motion for partial summary judgment will be denied.

2. Whether Respondent Properly Calculated Petitioner's Distributive Share

Under Rule 142(a)(1), respondent bears the burden of proving an increased deficiency. Respondent's determination is based on petitioner's income analysis of the 1998 taxable year and the Massachusetts State court jury's finding in petitioner's favor. Petitioner acknowledges that he prepared his income analysis and that the jury found in his favor that the partners' distributive shares should be allocated according to the new agreement. In his response to respondent's motion for summary judgment, however, petitioner does not state that respondent incorrectly calculated his distributive share on the basis of the income analysis and the new agreement, nor does his affidavit create a genuine issue of fact in that regard. Instead, petitioner argues: "The partnership received deposits. To have income the tests established by the Courts, the Internal Revenue Code and the regulations must be met. As is detailed in Petitioner's memorandum those tests were not met." Petitioner's burden on summary judgment is to set forth specific facts which show that a genuine question of material fact exists. See *Grant Creek Water Works, Ltd. v. Commissioner*, 91 T.C. at 325; *Casanova Co. v. Commissioner*, 87 T.C. at 217. Petitioner does not dispute the facts pertinent to the calculation of his distributive share of the partnership's income for the year in issue.

Rather, petitioner argues that the deposits to the partnership's account for that year are not income to him as a matter of law. As we discussed above, a partner must include his distributive share of partnership income whether or not it is distributed to him. Accordingly, we conclude that respondent is entitled to summary judgment on the issue of the calculation of petitioner's distributive share.

3. Whether Petitioner May Deduct Certain Business Expenses

Deductions are a matter of legislative grace. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992). The taxpayer bears the burden of proving he is entitled to deductions and must present adequate documentation to support any deductions claimed. *Welch v. Helvering*, 290 U.S. 111, 115 (1933); see also *Nowland v. Commissioner*, 244 F.2d 450, 453 (4th Cir. 1957) (holding the taxpayer bears the "burden of proving the amount of deductible expenses since deductions are a matter of statutory privilege and must be shown by substantial evidence"), affg. T.C. Memo. 1956-72. Viewing the factual inferences in the light most favorable to the nonmoving party, as we must on a motion for summary judgment, we do not find that a genuine issue of material fact exists as to the business expense deductions. See *Craig v. Commissioner*, 119 T.C. at 260; *Dahlstrom v. Commissioner*, 85 T.C. at 821; *Jacklin v. Commissioner*, 79 T.C. at 344. Petitioner claims $1,799 in additional trade or business expense deductions that he did not include on his 1998 individual tax return. In response to respondent's motion for summary judgment, petitioner merely asserts that he is entitled to the deductions as trade or business expenses and states that he has provided respondent with evidence

of those expenses.[10] The party opposing summary judgment must set forth specific facts which show that a genuine question of material fact exists and may not rely merely on allegations or denials in the pleadings. *Grant Creek Water Works, Ltd. v. Commissioner*, supra at 325; *Casanova Co. v. Commissioner*, supra at 217. Petitioner has failed to meet his burden to come forward with specific facts showing a genuine issue of material fact exists. Petitioner has not provided adequate substantiation of the expenses or provided any explanation or description of his entitlement to deduct the expenses. Accordingly, respondent is entitled to summary judgment. To reflect the foregoing, An appropriate order and decision will be entered.

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[10] Petitioner claims that copies of certain checks in respondent's files substantiate these expenses. As respondent points out, these checks total $3,790.29, and petitioner is claiming only $1,799 as deductible trade or business expenses. Moreover, these checks are not self- explanatory as to the nature of the expenses claimed

INTERNAL REVENUE CODE SECTION 702.

INCOME AND CREDITS OF PARTNER

(a) GENERAL RULE

In determining his income tax, each partner shall take into account separately his distributive share of the partnership's--

(1) gains and losses from sales or exchanges of capital assets held for not more than 1 year,

(2) gains and losses from sales or exchanges of capital assets held for more than 1 year,

(3) gains and losses from sales or exchanges of property described in section 1231 (relating to certain property used in a trade or business and involuntary conversions),

(4) charitable contributions (as defined in section 170©),

(5) dividends with respect to which section 1(h)(11) or part VIII of subchapter B applies,

(6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(7) other items of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary, and

(8) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

(b) CHARACTER OF ITEMS CONSTITUTING DISTRIBUTIVE SHARE

The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (7) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(c) GROSS INCOME OF A PARTNER

In any case where it is necessary to determine the gross income of a partner for purposes of this title, such amount shall include his distributive share of the gross income of the partnership.

(d) CROSS REFERENCE

for rules relating to procedures for determining the tax treatment of Partnership items see subchapter c of chapter 63 (section 6221 and following).

INTERNAL REVENUE CODE

SECTION 703. PARTNERSHIP COMPUTATIONS

(a) INCOME AND DEDUCTIONS

The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that--

(1) the items described in section 702(a) shall be separately stated, and

(2) the following deductions shall not be allowed to the partnership:

(A) the deductions for personal exemptions provided in section 151,

(B) the deduction for taxes provided in section 164(a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

©. the deduction for charitable contributions provided in section 170,

(D) the net operating loss deduction provided in section 172,

(E) the additional itemized deductions for individuals provided in part VII of subchapter B (sec. 211 and following), and

(F) the deduction for depletion under section 611 with respect to oil and gas wells.

(b) ELECTIONS OF THE PARTNERSHIP

Any election affecting the computation of taxable income derived from a Partnership shall be made by the partnership, except that any election under--

(1) subsection (b)(5) or (c)(3) of section 108 (relating to income from discharge of indebtedness),

(2) section 617 (relating to deduction and recapture of certain mining exploration expenditures), or

(3) section 901 (relating to taxes of foreign countries and possessions of the United States),

shall be made by each partner separately.